

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street
San Francisco, California 94105**

**NOTICE OF PROPOSED EMERGENCY READOPTION
PURSUANT TO CALIFORNIA INSURANCE CODE SECTION 12921.7**

**Consideration of Losses and Loss Exposure
In Residential Property Insurance Rating and Underwriting**

File No. ER03030135

February 23, 2004

This regulation supersedes the Advisory Notice entitled “Eligibility Guidelines and the Use of Loss Information by Residential Property Insurers” dated April 24, 2003.

California Insurance Commissioner John Garamendi (the Commissioner) hereby provides notice pursuant to California Insurance Code §12921.7 that he will submit for readoption Title 10, Chapter 5, Subchapter 3, Article 7.2, §2361 of the California Code of Regulations (Cal. Code Regs., tit. 10, §2361) to the Office of Administrative Law for approval pursuant to California Government Code §11346.1(h).

The emergency regulations (10 CCR §2361) implement and make specific California Insurance Code §§791.02, 1857, and 1861.05.

This Notice includes a description of the problem the regulations are intended to resolve, an explanation of the justification for the adoption of the emergency regulations, and a copy of the text of the emergency regulations.

The Notice will be provided to every person, group, and association who has previously filed a request for notice of all regulatory actions with the Commissioner, as well as to every person, group, and association having filed a request to receive only notices of regulations specifically involving Property and Casualty insurance. Copies of the Notice, and the text of the regulations, are available at the Department of Insurance, 45 Fremont Street, 21st Floor, San Francisco, California 94105, as well as on the Department’s “Proposed Regulations” web page, accessible at <http://www.insurance.ca.gov/docs/FS-Legal.htm>.

The regulation will be submitted to the Office of Administrative Law not less than five (5) working days after the mailing of this Notice. Questions regarding this rulemaking action should be directed to: Donald P. Hilla, Senior Staff Counsel, Department of Insurance, 45 Fremont Street, 21st Floor, San Francisco, CA 94105,

hillad@insurance.ca.gov. Electronic submissions are encouraged but should be accompanied by hardcopy submissions.

Description of Problem and Necessity for Regulations

Under California law an insurer may not base underwriting decisions solely on information gathered from insurance-support organizations, without obtaining further personal information from the insured. (Ins. Code §791.12(b).) Under California law an insurer may not refuse to issue a policy for homeowners insurance under conditions less favorable to the potential insured than to other comparable, potential insureds. (Ins. Code §679.71) Under California law underwriting plans and eligibility guidelines may not be arbitrary or unfairly discriminatory. (Ins. Code §§1861.03, 1861.05(a); Cal. Code Regs., tit. 10, §2360.0 et seq.) Under California Law, during the prior approval process, the Commissioner may consider rating manuals, rating plans, underwriting rules and eligibility guidelines, and any other information that may be required. (Cal. Code Regs., tit. 10, §2643.3(b), 2648.4 and Ins. Code §§1857, 1857.2, 1857.3, 1857.7, 1857.9, 1864 and 1861.05(b).) Additionally, pursuant to this regulation, insurers must maintain documentation to allow CDI to determine compliance with the law. (Ins. Code §1857.)

Despite these prohibitions, the California Department of Insurance (“CDI”) continues to receive numerous complaints from policyholders who have had their insurance coverage cancelled or not renewed for the act of making a claim or for simply making an inquiry about coverage. CDI also has received voluminous complaints from policyholders that have been denied coverage or had coverage terminated due to insurance companies relying solely on insurer-support organization databases that have been shown to rely on and contain incomplete or erroneous loss history data. CDI has received complaints that an insurer cancelled a policy after a policyholder filed a claim for water damage caused by a leaky roof, even though the roof was subsequently replaced, making the risk of future loss negligible. This regulation makes it clear that such practices are not permissible. CDI has also received complaints from policyholders that were unable to obtain coverage as a result of information contained in Comprehensive Loss Underwriting Exchange (CLUE) reports despite the fact that the information was incorrect. Pursuant to this regulation, as required by Ins. Code §791.12, an insurer must verify specified information before it can be used as the basis for an adverse underwriting decision.

While there are laws specific to insurance rating and underwriting that address cancellation, nonrenewal and eligibility for homeowners insurance, both the insurance industry and the insurance consuming public are unclear as to the exact application of these laws. This regulation clarifies and makes specific the application of these laws in California. Specifically, this regulation clarifies and makes specific the interaction of existing law governing homeowners insurance underwriting and rating.

A significant number of Californians found it impossible to purchase insurance, or had their insurance cancelled or not renewed due to an insurer’s cancellation, nonrenewal and underwriting rules, in noncompliance with California law. This crisis was evidenced in

the startling increase in the number of consumer complaints received by CDI and by scores of media reports on the lack of availability of homeowners policies and the impact on not only consumers but also the real estate and financial industries.

The Commissioner recognized the growing problem and attempted to resolve the situation by working with individual insurers and by communicating to the industry as a whole. These efforts were met with a lawsuit challenging the Commissioner's authority to enforce the insurance laws. (American Insurance Association; Association of California Insurance Companies; Personal Insurance Federation of California v. John Garamendi, Superior Court of the State of California, County of Sacramento, Case No. 03CS00839.) The Court's preliminary conclusion and ruling was that the Commissioner's communication with the industry should have been accomplished through, or pursuant to, the Administrative Procedure Act. This matter is currently on appeal to the Court of Appeal of the State of California in and for the Third Appellate District (Court of Appeal Number C045000).

Justification for Adoption of Emergency Regulations

During the course of the lawsuit challenging the Commissioner's authority to enforce the insurance laws, insurance industry trade groups claimed the industry was confused regarding the interpretation and interrelationship of the various applicable statutes and regulations. This regulation was designed to comply with the judge's order and to eliminate confusion regarding the implementation of existing law.

As the homeowners insurance market continued to show signs of stress and insurers perpetuate "use it and lose it" underwriting rules (whereby the filing of a claim or even a coverage inquiry results in cancellation of an insurance policy), the Commissioner believed immediate rulemaking action was necessary to protect the health, safety and welfare of California consumers.

An emergency regulation was the only way the Commissioner could immediately protect the health, safety and welfare of the insurance consumers of this state.

CDI experienced an unprecedented increase in complaints from consumers regarding homeowners insurance issues. These complaints related to cancellation, nonrenewal and eligibility in homeowners insurance lines.

Throughout 2001, CDI received only 318 formal complaints regarding homeowners insurance. In contrast, by the third quarter of 2002, CDI had received 1,200 written complaints from consumers, making the subject of homeowners insurance the number one consumer complaint issue in Property and Casualty lines at the Department of Insurance. CDI continues to receive an inordinate number of complaints on this issue.

The Commissioner believes that the unprecedented increase in the number of complaints relating to cancellation, nonrenewal, and unavailability of homeowners insurance evidenced a homeowners insurance availability crisis in California. The repercussions of

such a crisis threaten immediate harm in the real estate and financial markets and threaten to further undermine an already fragile California economy. A crisis of this kind also has an immediate and profound effect on the consumers of this state who may be unable to either purchase or sell a home or who upon cancellation may be involuntary transferred into the costly residual or forced-place insurance markets.

The stated purpose of Proposition 103 “is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians.” The Commissioner is charged with enforcing Proposition 103 and all other Insurance Code provisions. With the growing availability crisis, the Commissioner believes proposing this regulation on an emergency basis is necessary to ensure homeowners insurance remains available in California.

As a result of Superior Court Judge Raymond M. Cadei’s order it became necessary for the Commissioner to adopt a regulation on an emergency basis to implement, interpret and make specific the California insurance laws as they relate to homeowners insurance. As this matter is currently pending in the Court of Appeal in and for the Third Appellate District, the emergency regulations need to be readopted in order to remain effective during the pending appeal and subsequent promulgation of permanent regulations.

Text of the Proposed Regulations to be Adopted

The proposed regulation text is attached.